STATE OF CALFORNIA
ELECTRICITY OVERSIGHT BOARD

Gray Davis, Governor

September 23, 2002

VIA ELECTRONIC DELIVERY FOR FILING

Hon. Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, D.C. 20426

Re: Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities
Docket No. PL02-7-000

Dear Ms. Salas:

The California Electricity Oversight Board hereby submits for filing electronically its Comments Regarding the Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities issued on August 1, 2002.

Thank you for your assistance.

Sincerely,

/s/ Sidney L. Mannheim

Sidney L. Mannheim
Senior Staff Counsel
California Electricity Oversight Board

tel 916.322-8601 770 L St., Suite 1250, Sacramento, CA 95814 fax 916.322-8591

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities — Docket No. PL02-7-000

COMMENTS OF THE CALIFORNIA ELECTRICITY OVERSIGHT BOARD REGARDING THE STANDARD OF REVIEW FOR PROPOSED CHANGES TO MARKET-BASED RATE CONTRACTS FOR WHOLESALE SALES OF ELECTRIC ENERGY BY PUBLIC UTILITIES

Pursuant to the Commission's August 1, 2002 Notice of Proposed Policy Statement in the above captioned docket, the California Electricity Oversight Board ("CEOB") hereby files its comments regarding the proposed new policy for the Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities. The Commission is proposing to adopt a general policy concerning the standard of review that must be met to justify proposed changes to market-based rate contracts for wholesale sales of electric energy by public utilities. In doing so, the Commission proposes to clarify the application of the *Mobile-Sierra* doctrine by requiring parties to a contract to include specific language in their contracts in the event the parties propose to bind themselves to the "public interest" standard rather than the "just and reasonable" standard.

In summary, the CEOB has no objection to the ability of parties to a contract to bind themselves to the "public interest" standard, provided that it is bargained and not the result of undue influence or the exercise of market power. In addition, the CEOB has no objection to the proposed contractual language to be inserted in a contract to effect parties' waiver of the "just and reasonable" standard except to observe that the creation of

boiler-plate language and its appearance in a multitude of documents may result in many instances where the inclusion of the language was not bargained for. Thus, before the Commission applies the public interest standard in a Section 205 or 206 proceeding filed by one of the parties to a contract that includes the waiver language, the Commission should satisfy itself that the party's waiver of its Section 205 and 206 rights was bargained for. The CEOB, however, strongly opposes any suggestion that private parties to a contract should be able to bind the Commission or a third party with respect to the applicable standard of review.

I. Background

The "purpose of the *Mobile-Sierra* doctrine is to preserve the benefits of the parties' bargain as reflected in the contract, assuming that there was no reason to question what transpired at the contract formation stage." *Atlantic City Electric Co. v. FERC*, 295 F.3d 1, 12 (D.C. Cir. 2002) (citing *Town of Norwood v. FERC*, 587 F.2d 1306, 1312 (D.C. Cir. 1978)). The *Mobile-Sierra* doctrine "represents the Supreme Court's attempt to strike a balance between private contractual rights and the regulatory power to modify contracts when necessary to protect the public interest." *Northeast Utilities Service Co. v. FERC*, 55 F.3d 686, 689 (1st Cir. 1995.) "[A]bsent contractual language 'susceptible to the construction that the rate may be altered while the contract[ ] subsist[s],' the *Mobile-Sierra* doctrine applies." *Texaco, Inc. v. FERC*, 148 F.3d 1091, 1096 (D.C.Cir.1998) (quoting *Appalachian Power Co. v. FPC*, 529 F.2d 342, 348 (D.C.Cir.1976)).

Under the *Mobile-Sierra* doctrine the Commission may abrogate or modify freely negotiated private contracts that set firm rates or establish a specific methodology for setting the rates for service and that deny either party the right to unilaterally change

those rates, only if required by the "public interest." *Texaco, Inc. v. FERC*, 148 F.3d 1091, 1095 (D.C. Cir. 1998). The Commission has used the "public interest" standard "to modify the terms of a private contract when third parties are threatened by possible 'undue discrimination" or imposition of an 'excessive burden.'" *Northeast Utilities Service Co. v. FERC*, 55 F.3d 686, 691 (1st Cir. 1995) (quoting *Northeast Utilities Service Co. v. FERC*, 993 F.2d 937, 961-62 (1st Cir. 1993)).

The *Mobile-Sierra* doctrine concerns when the "just and reasonable" standard can be replaced with the "public interest" standard. The statutorily created "just and reasonable" standard derives from the Federal Power Act (FPA), Sections 205 and 206. The FPA generally requires that all rates, terms and conditions be just and reasonable. The "public interest" standard was first recognized by the Supreme Court in 1956 in *FPC v. Sierra Pacific Power Co*, 350 U.S. 348 (1956). The "public interest" standard is much more restrictive than the "just and reasonable" standard of Section 205 of the Act. See *Potomac Electric Power Co. v. FERC*, 210 F.3d 403, 407 (D.C. Cir. 2000); *Texaco*, 148 F.3d at 1097. That is, under the "public interest" standard, the Commission may enforce the terms and conditions of a contract even if they are unjust and unreasonable.

II. Parties Can Waive Their FPA Rights And Bind Themselves To The Public Interest Standard Of Review, But Such A Waiver Cannot Bind The Commission Or A Third Party

Assuming its is bargained for, and not a result of undue influence or the exercise of market power, parties should have the right to waive their rights under Sections 205 and 206 of the Federal Power Act to challenge the terms and conditions of a contract under the "just and reasonable" standard and agree to be mutually bound by the "public

interest" standard. As noted above, the CEOB does not object to the Commission's proposed language reflecting the agreement to be bound by the "public interest" standard.

The CEOB, however, strongly maintains that neither the Commission, nor a third party, can be bound by the parties' designation of the "public interest" standard. The waiver of the "just and reasonable" standard and the agreement to be mutually bound by the "public interest" standard should not create a right to the "public interest" standard. *See, Wilmington Trust v. United States Dist. Court*, 934 F.2d 1026, 1029 (9th Cir. 1991) (waiver of the right to a jury trial by proceeding in admiralty does not create right to a non-jury trial).

The Federal Power Act requires, in the first instance, that all rates, terms and conditions be just and reasonable. That must be the Commission's starting point; application of the "public interest" standard of review should be limited to Section 205 and 206 proceedings filed by parties' that have waived their right to the "just and reasonable" standard.

In complaints filed by third parties or in the event the Commission initiates a section 206 proceeding, the default standard of review should be the "just and reasonable" standard. Third parties have not waived their right to just and reasonable rates terms and conditions. Moreover, when the Commission initiates its own investigations, it is, presumably, not doing so to protect the interests of any of the parties to a contract—who are presumed to be able to protect themselves—but to protect third parties and broader interests in market integrity ensuring, for example, that the rates consumers ultimately pay are just and reasonable.

Even if the "public interest" standard were to nominally apply to independent Commission investigations or to third party complaints, it is not the same "public interest" standard that would apply in Section 205 or 206 complaint filed by a party to the contract. As the Commission has explained

> In the "classic" *Mobile Sierra* situation, for example—when a seller utility unilaterally seeks an increase from a fixed-rate contract already on file with the Commission-the pubic interest (as opposed to the private interest of the party seeking the rate increase) only rarely is served by making the requested change (that is, granting the required increase), an a strict standard is appropriate. In other situations, however—when, for example, as here, the Commission is presented with an agreement for the first time and concludes that certain modifications to material rate provisions are necessary to protect the interest of non-parties—the public interest is served y making the modifications, and a more flexible standard is therefore appropriate.

Northeast Utilities Service Co., 55 F.3d at 692 (quoting 66 FERC ¶ 61,332 at 62,076 (1994)). As the United States Court of Appeals for the First Circuit explained, application of the standard of review "depends on whose ox is gored and how the public interest is affected." *Id.* at 691. The "public interest" standard itself is not, and cannot be, a single standard.

III. When The Contract Includes The Waiver Language The Commission Should Not Apply The Public Interest Standard Until It Has Ascertained That The Waiver Was Voluntary

The mere inclusion of the *Mobile-Sierra* language that the Commission proposes in a contract cannot justify the presumption that a party's waiver of Section 205 and 206 rights was made knowingly and voluntarily. As the Court of Appeals has observed, the "purpose of the *Mobile-Sierra* doctrine is to preserve the benefits of the parties' bargain as reflected in the contract, *assuming that there was no reason to question what*

transpired at the contract formation stage." *Atlantic City*, 295 F.3d 1, 12 (D.C. Cir. 2002) (emphasis added).

In this regard, the CEOB is concerned that boiler-plate language will begin to appear in standard form agreements and, more troubling, in fax and email confirmation of short term and spot sales made by telephone where it is quite possible that that a waiver of Section 205 and 206 rights was not bargained for. The market has evolved from the era when the *Mobile-Sierra* doctrine was developed. It evolving from a world were parties could negotiate unique agreements that would apply in lieu of a tariffed cost-of-service rate to telephone transactions at market based rates with not cost-of-service default tariff rate. There is likely to be little question in the case of a traditional long term power contract, for example, that a waiver of a party's section 205 and 206 rights was the result of a bargained for exchange. Today, on the other hand, when dealing with form agreements and one-sided confirmations of transactions that may have been hastily agreed to, and, in the absence of a tariffed cost-of-service default rate, inclusion of the Commission's boiler-plate language should not create any presumption that the any knowing or intelligent waiver occurred let alone any presumption that the waiver was bargained for. Thus, the Commission must consider evidence outside the four-corners of a contract in the event a party to the contract claims that the waiver was a result of undue influence, market power, or any other reason that would support a finding that the waiver was not entered into either knowingly or voluntarily or as a result of a bargained for exchange.

IV. Conclusion

The CEOB believes that the Commission's proposed *Mobile-Sierra* language can provide additional clarity to reflect parties' intentions. Parties agreeing to be bound by the *Mobile-Sierra* public interest standard should not be able to bind the Commission either with respect to its own investigations and third-party claims. In addition, the Commission should only apply the public interest standard so long as there is no reason to question whether the party's waiver of the just and reasonable standard was knowing and voluntary.

Dated: September 23, 2002

Respectfully submitted,

/s/ Erik N. Saltmarsh

Erik N. Saltmarsh, Chief Counsel
Sidney L. Mannheim, Senior Staff Counsel
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
(916) 322-8601